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The Political Economy of Petroleum Dependency

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In Brief 2016/6

Petroleum dependency has become a hot public policy topic in Timor-Leste. The tendency is to focus on financial aspects, which relate to the prediction that the Bayu-Undan gas field will run out soon. Although this is the most pressing issue (at least for the short and medium term), this In Brief examines the political–economic side of oil dependency, focusing on how it affects state–society relations, and the state's role in overall economic development. The paper is informed by my experience as a staff member in the president's office, including public policy discussions I have had and my discussions with people in various settings.

Oil and the State's Expansion

It is not healthy for any country to depend solely on a single commodity. It is even worse to depend on a commodity like petroleum, a non-renewable source that relies on a high-tech and capital-intensive industry and is subject to unpredictable prices in the international market (Karl 2004:662). Given these characteristics, many scholars view petroleum revenues as rent: 'the economic return to natural extraction that exceeds production and transport costs and some "normal" return to capital', even when all the production factors are at their best use (Dunning 2008:6). Almost 90 per cent of Timor's annual expenditure is derived from petroleum and more than 50 per cent of its domestic economy comes from a recycling of petrodollars through the state's budget. Indeed, as Charles Scheiner of La'o Hamutuk has put it, 'oil swamps the entire economy' (Scheiner 2015:74).

Timor-Leste is an oil-dependent country where there is not much oil (World Bank 2013). Timor's oil dependency is an indication of underdeveloped non-oil sectors. At the same time, oil revenues have enabled the state to expand its bureaucracy, provide social services, build infrastructure and establish social security schemes. Oil revenues also enable the state to finance mega-projects like the national electrification scheme, ZEESM and the Tasi Mane Project. The direct impact of this spending is economic growth, which is primarily driven by the state's investment and consumption. It is expected that investment in infrastructure will push economic growth and promote private-sector activities.

Since 2008, the government of Timor-Leste has invested heavily in infrastructure, such as electricity, irrigation and office buildings. It has also invested in constructing and improving roads across the country, to increase connectivity. The government has also established cash transfer schemes for groups such as veterans, the elderly and single-parent households. Furthermore, various local development schemes are implemented to build the financial capacity of the local contractors, and to improve rural infrastructure. These schemes are based on an overall macroeconomic rationale that the government will inject capital into the domestic market, thus increasing purchasing power. These, in turn, will create a demand for goods and services, and the private sector will respond.

In terms of social services such as education and health, Timor-Leste has made remarkable progress in the past 15 years. In relation to education, the gross enrolment rate has increased significantly as access to education has expanded. In the health sector, major achievements include the decline of the mortality rate for children less than five years old, the decline of the probability of children dying before their first birthday and a decline in malnutrition.

Combinations of all this have shaped the current state–society relations in Timor. As with many other postcolonial countries, the government has inherited various problems from colonisation and military occupation. The ability of the state to solve these problems will shape state–society relations. Social services and infrastructure become sectors when the state is visible and strengthens its legitimacy in the wider society.

Oil and the Rentier State

Amid all of this, the impacts of oil dependency go beyond financial terms. On the negative side, Timor-Leste's experiences have shown that petroleum dependency affects many aspects of social, political and economic life. Oil dependency has led to a rentier state, where the state's policies are influenced by the fact that a high proportion of its revenues are derived from external sources.

Petroleum dependency shapes economic dynamics in a peculiar way. Although non-oil gross domestic product is a way of domestic economy measurement, it represents only a portion of the economic activities that revolve around the recycle of petrodollars, and mainly in Dili. It does not reflect the lives of people who live outside the formal economy. The government's spending through public administration, procurement, construction and social security schemes dominates the economy.

In a country where rent is relatively high, the state is almost totally independent of the domestic economy. Domestic revenue is around only 13–15 per cent of the state's annual spending. Rent captures the national planning of the country, as money is the centre of planning and evaluation. Money is viewed as the solution to everything, by which every development challenge can be solved. Civil society's approach to evaluating the government's performance based on its rate of budget execution only reinforces the tendency of viewing money as the solution.

Relative independence from the domestic economy provides a condition where the state can increase its annual spending independently from the domestic economy. Some scholars argue that this undermines politicians' commitment to developing the non-oil economy. From the rentier state paradigm, the state in Timor-Leste plays an intermediary role by allocating oil revenues to the rest of the society. This role becomes more obvious as public pressure for infrastructure and social services increases. However, when the money is allocated, and the state's institutions are not well designed, it leads to mismanagement and abuse of power.

As the state embarks on a program of massive spending and establishes various subsidy schemes, these policies have various impacts on society. People compete for rent through political connections and political favouritism, thus undermining the spirit of hard work and creativity. The gap between rich and poor is also growing. Economic growth obviously has benefited some people, especially in Dili over others. Agriculture, the main source of livelihood for people in rural areas, is stagnant. The 2011 household income survey showed that the richest households' income was almost 1700 per cent higher than that of the poorest households. In per capita terms, the income of the richest 10 per cent is 14 times higher than the income of the poorest 10 per cent (National Statistics Directorate 2011).

In conclusion, impacts of oil dependency go beyond questions of financial sustainability. On one hand, oil money enables the state to expand and make itself visible to society. On the other hand, it also affects the way the state and society interact with each other, in many ways shaping economic structures. These dynamics are evident in Timor-Leste's experiences.

Author Notes

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We acknowledge the Australian Government's support for the production of the *In Brief series*.

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